VZCZCXRO8780
RR RUEHBZ RUEHDU RUEHJO RUEHMR RUEHRN
DE RUEHLG #0594/01 3081254
ZNR UUUUU ZZH
R 041254Z NOV 09
FM AMEMBASSY LILONGWE
TO RUEHC/SECSTATE WASHDC 0042
INFO RUCNSAD/SOUTHERN AF DEVELOPMENT COMMUNITY COLLECTIVE
RUEHLO/AMEMBASSY LONDON 0410
RUEHLMC/MILLENNIUM CHALLENGE CORPORATION WASHINGTON DC

UNCLAS SECTION 01 OF 02 LILONGWE 000594

SENSITIVE
SIPDIS

LONDON FOR AF WATCHER PETER LORD

E.O. 12958: N/A
TAGS: ECON EFIN EAID MI
SUBJECT: MALAWI: ECONOMY WEAKENS AS IMF BEGINS NEW MISSION

REF: A. LILONGWE 489
¶B. LILONGWE 78
¶C. 08LILONGWE 700

LILONGWE 00000594 001.2 OF 002

¶1. (SBU) Summary: Malawi escaped relatively unscathed from the global economic downturn, but strains on the economy are becoming increasingly apparent, with a shortage of foreign exchange particularly problematic. An IMF team is in the country discussing with the GOM a possible financial program, and will be addressing issues of fiscal policy and the exchange regime. With donor support funding over forty percent of the GOM budget, and that support often contingent upon a good report from the IMF, the potential consequences of this mission are significant. Notwithstanding frustrations with some GOM economic policies, it is unlikely that the IMF or donors will want to jeopardize broader progress by withholding support, even if the GOM resists IMF policy prods. End summary.

CONTINUED GROWTH MASKS WEAKNESS IN THE ECONOMY
-- -

¶2. (U) Malawi's economy continued to grow in 2009, with GDP growth projected at over 4%. Malawi's financial sector weathered the global economic crisis with little damage, largely due to relatively few links to the global financial system and a generally risk averse lending culture. Another good growing season produced a third successive year of surplus in the maize crop, Malawi's staple food.

¶3. (U) Signs of weakness are beginning to appear, however. Auction prices in the 2009 season for Malawian tobacco, the country's primary export commodity, were down twenty-one percent from 2008's record levels. This trend reflected generally lower global commodity prices. While the price decrease was partly offset by a record crop size, tobacco earnings were still down USD 39 million, over eight percent lower than in 2008. Prices for cotton were also down, leaving many farmers with little profit.

¶4. (SBU) Malawi's foreign exchange reserves continued to be weak, even through the end of the tobacco season when forex reserves typically peak (Ref A). The shortage led to companies developing large arrears owed to foreign suppliers, resulting in further costs from interest charges on late payments, storage and demurrage costs at ports. According to a paper prepared by the Public Private Dialogue Forum, a group of GOM and private sector stakeholders, other effects of the shortage are that companies have lost advantageous business terms, commercial credit has become tighter, suppliers have suspended open accounts, and some companies have experienced stock-outs due to late payments. Other companies have scaled down or temporarily stopped production

since raw materials are not available or not delivered on time. Thomas Munthali, president of the Economics Association of Malawi, acknowledged adverse affect of the foreign exchange shortage on Malawi's overall economy, and said that going forward the impact will be especially great, although a detailed study would be needed to quantify it.

IMF MISSION POTENTIALLY PIVOTAL

¶5. (U) On October 27, an IMF team initiated a review with potentially serious consequences for Malawi. At a briefing for the international donor community, IMF Country Director for Malawi Janet Stotsky said that the mission hopes to complete the Article IV consultations begun earlier in the year, work with the new government on a number of issues of interest to the IMF, and, discuss the existing Exogenous Shock Facility (ESF) program (Ref C).

¶6. (SBU) Key issues for the IMF include: 1) Malawi's fiscal position, 2) reserves status, and 3) structural measures. Stotsky noted that Malawi had failed to meet the goals of the ESF program. Malawi missed program targets on domestic borrowing and reserve levels, failed to repay debt as planned, spent well beyond budget levels, and failed to increase its reserves, which in fact shrank during the period. She added that the IMF is seeking an assessment of how the current budget is being handled.

¶7. (SBU) Stotsky also noted that Malawi's reserve position remains weak, and that the injection of USD 80 million in Special Drawing Rights (SDRs) had helped, but it was not enough. She emphasized that the IMF had concerns regarding the overall foreign exchange regime. Structural issues the IMF plans to discuss include bringing the private sector into

the agricultural subsidy program and issues of public financial management, especially within the subsidy program.

¶8. (SBU) The IMF team is prepared to begin negotiations on a new program for Malawi, which would be an Extended Credit Facility (ECF). The ECF replaces the Poverty Reduction Growth Facility (PRGF), but with lower financing charges and better access, according to Stotsky. She said that under the best case scenario, the current mission could lay out a framework agreement that could go to the IMF board in January. Any new agreement, however, will need to address the failure of the GOM to meet the ESF targets.

FOREIGN EXCHANGE REGIME AND SPENDING ARE KEY

¶9. (SBU) Malawi's low foreign exchange reserves are a major concern for the IMF, which considers reform of the exchange regime essential. It believes that the Malawi kwacha is overvalued at its current exchange rate. Stotsky noted that the advantage of a three-year ECF program would be sufficient time for a rational transition to a new regime. The IMF believes that institutionally Malawi should be able to make such a transition. Stotsky emphasized that the team has not come with a mandate to get exchange reform or walk away, but she made clear the IMF belief that trying to address the reserve issue solely through fiscal/monetary measures could be damaging to the economy. Stotsky did not indicate how the IMF would react if the GOM proves completely intransigent on exchange policy.

¶10. (SBU) The IMF is also concerned with the GOM's lack of fiscal discipline over the past year. Overspending on the input subsidy program (Ref. B) raised particular concern, but Stotsky noted the problem encompasses a more general inability to keep spending within the budget. The donor community is also concerned over spending -- donors contributed 42 percent to the GOM revenue in direct budget support in 2008-2009.

¶11. (SBU) The purchase by the GOM of an executive jet (a Dassault Falcon 900) for the president in particular has drawn the critical attention of the IMF mission. At a time when the IMF and donors are looking for responsible fiscal management from the GOM in order to justify their continued financial support, the expenditure of an estimated USD 20 million on this aircraft sends a very negative signal.

COMMENT

¶12. (SBU) The current IMF assessment comes at a critical point for Malawi. With economic strains growing, particularly with regard to foreign exchange reserves, continued IMF and donor support is key. The IMF clearly believes the GOM's exchange regime must change and donors are increasingly wary of budget overruns due to the subsidy program. Both benefactors wield substantial leverage, but it is not clear to what extent either is willing to use that leverage. We suspect that Malawi's solid democratic credentials and otherwise sound economic policies make it unlikely at this point that donors or the IMF will want to jeopardize progress by reducing support.
BODDE